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# North Korea: Turnaround in Foreign Debt Management and Trade Patterns

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An Intelligence Assessment

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# **North Korea: Turnaround in Foreign Debt Management and Trade Patterns**

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**An Intelligence Assessment**

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This paper was prepared by [ ] Office  
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### North Korea: Turnaround in Foreign Debt Management and Trade Patterns

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#### Key Judgments

*Information available  
as of 1 February 1985  
was used in this report.*

North Korea is showing signs of changing its debt management strategy. P'yongyang, which has not reestablished its international credit rating since first defaulting on its foreign debt payments 10 years ago, is:

- Putting a higher priority on exports—sales to the developed countries more than doubled in first half 1984 compared with first half 1983.
- Slashing imports, thereby registering a trade surplus in first half 1984.
- Working out agreements with creditors to reschedule a portion of its debt until later in the decade and into the 1990s.
- Making payments to several of its creditors, including Austria, Sweden, and Finland, to cover overdue principal and interest.

During 1981-83, North Korea gave little priority to its foreign debt; P'yongyang allocated resources to domestic demand, rather than to exports, and repeatedly missed debt payments. We do not know why North Korea changed course last year but believe several developments are influencing the regime. The disappointing results of the just-concluded seven-year economic development plan (1978-84), in which the economy fell far below almost every target, is perhaps the most important. P'yongyang may be considering a move away from the autarkic policies of the early 1980s as it develops its next economic plan. China's current opening to the West, Beijing's pressure on North Korea to adopt similar policies, and South Korea's surprisingly strong economic growth since 1983 are other factors that may be influencing P'yongyang.

We are unsure, however, whether North Korea's recent debt payments and export push reflect a new strategy to resolve the debt situation or merely a short-term effort at image building. P'yongyang may have hoped that a few payments would be enough to restore its access to Western credit.

If North Korean actions in 1984 were short term and the debt issue is not resolved, then we would expect the economy to plod along with only slow growth well into the 1990s. If, on the other hand, P'yongyang has made a long-term policy shift, perseveres with the necessary austerity, and restores its credit rating, then we would expect several years with little, if any, economic growth and the chance of fairly high rates of expansion by the end of the decade. Even if P'yongyang is embarking on such a policy course, however, the leadership may be unwilling to enforce the needed sacrifices over a period of several years, and backsliding is a possibility. We see no indications that P'yongyang is prepared to reduce defense spending to improve the economy's prospects.

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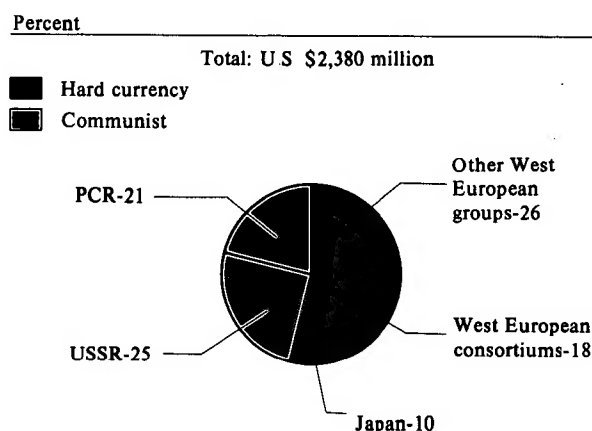
## North Korea: Turnaround in Foreign Debt Management and Trade Patterns

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### Origin of the Debt Problem

North Korea, desiring to speed up industrial development and foster economic modernization, purchased about \$1.3 billion in plant and equipment from West European nations and Japan during 1973-75. This compares with imports from those countries totaling about \$200 million during the three previous years. Inept management in bringing these plants on stream and a dramatic reversal in North Korean terms of trade—a plunge in nonferrous metal prices and sharply increased oil prices—resulted in accumulated obligations more than six times hard currency export earnings. In consequence, in 1974 North Korea became the first Communist country to default on its foreign debts.

**Figure 1**  
**North Korea: Foreign Debt, Mid-1984\***



\* Calculated at mid-1984 exchange rates.

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### Foreign Debt Position

We estimate that North Korea's hard currency debt now totals \$1.3 billion.<sup>1</sup> In addition, about \$1.1 billion in soft currency is owed to the Soviet Union, China, and East European countries. This soft debt to the Communist countries is covered by credits extended on very liberal terms, and repayment does not present the same burden as the hard currency debt.

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The ratio of North Korea's debt to GNP is less than 20 percent; by comparison, South Korea's ratio is over 50 percent. North and South Korea have similar debt-to-export ratios—that is, about 2 to 1. The North Korean economy, however, is more narrowly based and far less dynamic than South Korea's. More important, the poor credit rating for the past decade has left North Korea cut off from new credits, whereas South Korea easily taps international capital markets to finance its debt.

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The Japanese Government is the largest holder of North Korean hard currency debt with about \$240 million outstanding. Most of the credit extended to

<sup>1</sup> Calculated at mid-1984 exchange rates. The strong appreciation of the US dollar has substantially reduced North Korea's hard currency debt in dollar terms since most of the debt is denominated in European currencies. Dollar appreciation, for example, reduced the debt by about \$400 million last year.

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**Debt Management Strategy <sup>2</sup>**

During the early 1980s, P'yongyang paid little attention to meeting its debt obligations—except those due Japan, its major non-Communist trade partner. North Korea made about \$160 million in payments to Japan between 1980 and 1982, keeping fairly close to the terms of a 1979 agreement. During 1983, however, North Korea made few payments to any creditors, including Japan. [REDACTED]

In late 1983, P'yongyang changed its policy. In the first half of 1984, North Korea made payments to several of its West European creditors, including Sweden, Austria, Finland, and the two bank consortiums, to cover overdue principal and interest. We estimate that these payments amounted to about \$130 million. P'yongyang also worked out rescheduling agreements with France, Sweden, and the two consortiums to spread out principal repayments. The rescheduling with the bank consortiums is especially important because it delays principal payments on this \$400 million debt until 1988-95. As a result, North Korea will have a less burdensome servicing schedule over the next three years. [REDACTED]

**The Focus on Western Europe**

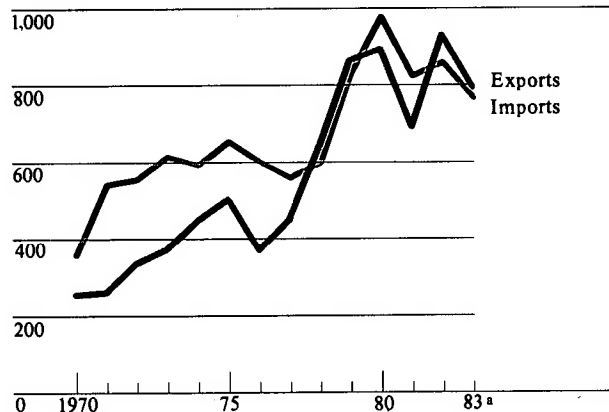
Putting priority on repaying West European rather than Japanese creditors may reflect a North Korean desire to diversify import sources and punish Japan for its imposition of sanctions following the Rangoon bombing of October 1983. P'yongyang has relied on Japan for about 70 percent of its imported capital equipment from the West in recent years. France and [REDACTED]

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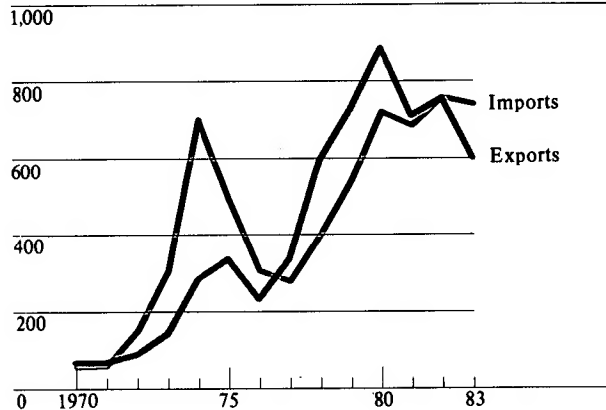
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**Figure 2**  
**North Korea: Trade, 1970-83**

Million U S \$  
Communist Countries



Non-Communist Countries



<sup>a</sup> Estimated. Based on partner-country trade data.

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West Germany have sold some equipment to North Korea but Austria, Sweden, and Finland have not returned to the North Korean market to any significant extent since the mid-1970s.

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### Trade Patterns <sup>3</sup>

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During 1981-83, North Korean exports declined as P'yongyang put greater priority on meeting domestic demand. Foreign sales in 1983—at \$1.4 billion—were about 20 percent below the 1980 peak level, despite an

<sup>3</sup> North Korea does not publish trade statistics. Our estimates are based primarily on partner country data. A variety of sources are used to estimate the arms portion of the trade.

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**Table 1**  
**North Korea: Trade, by Partner <sup>a</sup>**

Million US \$

	1980		1981		1982		1983	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
<b>World Trade</b>	<b>1,785</b>	<b>1,691</b>	<b>1,403</b>	<b>1,500</b>	<b>1,689</b>	<b>1,608</b>	<b>1,396</b>	<b>1,499</b>
Non-Communist	889	717	711	681	757	754	602	737
Developed	434	508	202	447	294	464	263	465
Japan	174	376	134	290	145	313	122	329
West Germany	167	33	49	30	134	34	127	23
France	17	5	4	69	3	45	3	46
Sweden	1	8	1	6	0	5	0	18
Austria	1	5	0	17	0	6	0	5
Finland	0	1	0	2	0	0	0	0
LDCs	455	209	509	234	463	290	339	272
Communist	896	974	692	819	932	854	794	762
USSR	438	443	348	388	500	440	410	345
China	303	374	232	300	304	281	254	273

<sup>a</sup> Exports and imports are f.o.b.

increase in arms exports.<sup>4</sup> Sales of nonferrous metals—traditionally North Korea's major export item—were particularly weak. P'yongyang also gave increased priority to Communist countries, particularly the Soviet Union, in allocating exports. This left fewer goods available for sales to hard currency markets.

in the first half of 1984, compared with the first half of 1983, rising from \$135 million to \$283 million. The surge in sales to the developed countries largely reflected increased gold sales to West Germany; sales to Japan—primarily nonferrous metals and steel—rose about 18 percent. Little information is available on trade with the LDCs in 1984, but exports to the Communist countries also increased in the first half of the year. Sales to the Soviet Union and China rose 8 percent and 25 percent, respectively.

North Korean imports did not decline as fast as exports during this period, partly because of increased oil imports. In 1983, oil accounted for about 30 percent of total imports, compared with 17 percent in 1980. North Korea's hard currency trade balance consequently shifted into deficit by 1983 after P'yongyang had registered surpluses averaging almost \$100 million annually between 1977 and 1980.

P'yongyang also reduced its imports substantially in first half 1984. Purchases from the developed countries were down by about one-third; imports from China fell almost 20 percent. As a result, North Korea sharply improved its trade balance. P'yongyang recorded a \$120 million trade surplus with the developed countries in first half 1984, compared with a \$120 million deficit in first half 1983, representing

In 1984, P'yongyang began putting increased priority on export markets. Foreign sales rose dramatically. Exports to the developed countries more than doubled

<sup>4</sup> Largely reflecting sales to Iran, North Korean arms sales, in our estimation, averaged about \$300 million annually in 1981-83.

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**Table 2**  
**North Korea: 1984 Trade Trends**

Million US \$

	First Half 1983	First Half 1984
<b>Exports</b>		
Developed countries	135	283
Of which:		
Japan	68	80
West Germany	65	200
USSR	200	217
China	100	125
<b>Imports</b>		
Developed countries	257	165
Of which:		
Japan	180	123
West Germany	12	16
France	27	2
USSR	201	207
China	137	113
<b>Trade Balance</b>		
Developed countries	-122	118
Of which:		
Japan	-112	-43
West Germany	53	184
France	-25	0
USSR	-1	10
China	-37	12

the first surplus in its trade with the developed countries in more than a decade. North Korea's trade balance with its two major Communist trade partners also shifted into surplus in first half 1984.

#### P'yongyang's Motives

In the early 1980s, P'yongyang adopted an inward-looking development strategy focused on agriculture, electric power, and transportation projects—sectors that depend heavily on domestically produced equipment. This policy of self-reliance followed an unsuccessful attempt by P'yongyang in the late 1970s to keep up with its debt obligations and restore its credit rating.

We believe, however, that this autarkic strategy has produced unsatisfactory results from P'yongyang's perspective. North Korea has just concluded its seven-year economic development plan (1978-84), and performance fell far below almost every target. We estimate real GNP growth during the period averaged 3 to 4 percent annually, slightly better than the LDC average but far short of the regime's 10-percent-per-year goal. Growth has been particularly weak in recent years and shortages continue to plague the economy.

The economy's poor showing may be prompting P'yongyang to shift policy back in favor of maximizing foreign exchange earnings and resolving the debt problem. P'yongyang may be trying to increase its access to Western equipment and technology for its next plan period to spur more-rapid long-term growth.

China's opening to the West and economic reform policies also may be influencing North Korean policy decisions. We believe that China has been encouraging P'yongyang to adopt economic reforms similar to its own. In September, shortly after Premier Kang Song-San visited Beijing, P'yongyang promulgated a joint venture law patterned after China's foreign investment regulations. North Korea has also been giving increased attention to light industry, another policy that follows China's example.

The surprisingly strong resurgence of the South Korean economy since 1983 probably also prompted P'yongyang to reconsider its policies. South Korean real GNP grew 8.5 percent per year in 1983-84. Under such circumstances, North Korea may have decided that it must acquire Western equipment and technology to compete with the South economically.

P'yongyang's debt management policies could also reflect a broader change in North Korea's political/economic strategy, exemplified by such developments as the North-South economic talks. But at this point, we are unable to determine if P'yongyang has altered its overall priorities and embarked on fundamental policy shifts.

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At the same time, we cannot rule out the possibility that P'yongyang's debt payments last year were nothing more than a short-term effort by the regime to improve its international image. P'yongyang may have hoped that a few payments would be enough to restore its access to Western credit. The regime may have no intention of keeping up with payments in 1985. [ ]

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#### A Tough Road Ahead

If P'yongyang's actions last year were short term and the debt issue is not resolved, then we would expect the North Korean economy to grow slowly during the next plan period. Under such conditions, only a reduction in defense spending or substantial foreign assistance—neither of which appears likely—would enable P'yongyang to do better than its poor showing of the past plan period. [ ]

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If, on the other hand, P'yongyang is embarking on a policy to resolve the debt issue, perseveres with the necessary austerity, and restores its credit rating, then the economic outlook would be brighter over the longer term. Resolving the debt situation would remove an important constraint on the long-term growth of the economy. A resulting inflow of Western technology would put North Korea in a better position to achieve strong rates of expansion in the 1990s. North Korea has abundant natural resources and can maintain high investment ratios. The new joint venture policy, if implemented and attractive to foreign investors, could also begin to pay dividends by the early 1990s. [ ]

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Getting the debt situation under control, however, would carry a stiff short-term cost, and we are not certain P'yongyang will be willing to enforce the necessary sacrifice over a period of several years. Maintaining a hard currency trade surplus to generate funds for debt obligations would require a significant diversion of economic resources to the export sector, as well as a curtailment of imports. Both of these steps would seriously slow domestic economic activity in the short run and further delay investment and military projects. Under such conditions, the North Korean leadership is likely to feel pressure to divert economic resources away from exports. [ ]

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#### What To Look for in 1985

##### Japan

*Interest payments due in June and December.*

##### European Bank Consortiums

*Interest payments due in February, May, August, and November.*

##### France

*Interest payments due in May and November.*

##### Sweden

*Principal and interest payments due; timing unknown.*

##### Finland

*Missed payment from October 1984 due, and 1985 payment due; timing unknown.*

##### West Germany

*Principal and interest due; timing unknown.* [ ]

[ ]

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P'yongyang's task is complicated because economic resources are already stretched thin. The heavy defense burden—an estimated 25 percent of GNP—is a particularly large drain on resources. We detect no indication that P'yongyang is willing to reduce defense spending or lower the priority of the military sector. In addition, P'yongyang has indicated that it wants to provide additional investment for consumer goods industries. Living standards have only increased marginally over the past decade. North Korea also faces pressure from its Communist country trade partners, particularly the Soviet Union, to meet export commitments, with Moscow using its oil leverage to press P'yongyang to fulfill trade obligations. [ ]

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The recent debt reschedulings—by stretching principal payments over a longer period—provide some relief. We estimate that North Korean interest and principal payments due its Western creditors will amount to about \$225-250 million annually over the next three years. North Korea's hard currency debt

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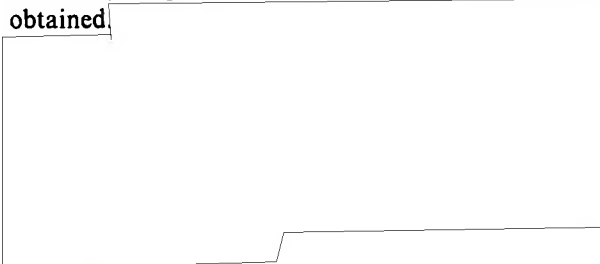
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service ratio—at 35 percent—has declined over the past decade because of the growth in North Korean exports, global inflation, and the lack of new borrowing. 

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P'yongyang's debt service burden will nonetheless be extremely tough to manage unless new credits can be obtained. 



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